RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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PRICE: Last week I was discussing the current market situation with a very knowledgeable friend. We both said that we were seeing a number of "glitches" and potential problems in the current stock market picture (a number of these glitches are listed below). But my friend cautioned, "Listen, we must never forget that we don't trade indications or technical disparities, we trade price." Good point and one one should never forget, price in the market is king, all other considerations are simply pawns that serve the king.

It reminds me of the old story -- Charlie, the broker, called Zimmerman, his best customer. "Zimmerman," said Charlie apologetically, "Remember that 5000 shares of Schlock-Net that we bought at 47, well, I've got good news and bad news." Zimmerman gulped, "Gimme the bad news first, Charlie." Charlie answered, "Well, last week Schlock-Net dropped from 47 to 3." Zimmerman groaned, "Oh my gad, well, what's the good news?" Charlie answered in a low voice, "The good news is that it collapsed on very low volume."

STRANGE SPLIT: We're now at a fascinating juncture in the stock market. Here's why I say that: **price action** in the stock market itself continues to be constructive. But four items give me pause: **(1)** Selling by corporate insiders has climbed to its highest level in five years. **(2)** "Commercials" (commercials are the big institutions, and they are usually correct) have now assumed a very heavy short position, one of the heaviest, in fact, since 1987. **(3)** Eurodollar rates (Eurodollars are dollar deposits in Europe) have turned up, meaning that dollar interest rates in the uncontrolled overseas markets are rising. **(4)** The dollar itself has suddenly weakened, and the Dollar Index has dropped sharply below its 34-day moving average. As I said, all the above are occurring in the face of a still-strong stock market, a market that saw the Dow Averages hit record highs last week on April 15. **Question:** Are stock market sophisticates selling while the public is still buying heavily? **Answer:** It seems so.

IRONY: During **1980-82**, at a time when stocks represented outstanding values, the public couldn't be induced to buy stocks or mutual funds. NYSE volume was running around 50 million shares a day. (Remember *Business Week's* cover story, "The Death of Equities"?) **Today**, with stocks at record high valuations, money is flooding into mutual funds at the rate of $1.7 billion **a day** and volume on the NYSE has increased 10-fold to better than 500 million shares a session. **Question:** Why did investors hate stocks when they were great values and why do they love stocks today when stocks are at their most expensive in history? **Answer:** That's the way the markets work -- and that's why the public always ends up losing money and hating Wall Street.

THE CONCEPT: What is the changing sentiment that has powered the Dow from 5000 in January 1996 to over 9100 in April 1998? What kind of thinking has allowed analysts to ignore all the time-honored measures of value such as dividend yield and price/earnings? The thinking, or let's call it the concept, is **extrapolating growth in earnings.** In other words, it isn't just earnings estimates for the next six months or so, it's **extrapolating earnings growth as far as a year or more ahead.**

On that basis, one can project (forecast) almost any level for the Dow. For instance, let's try a Dow price of 10,400 based on

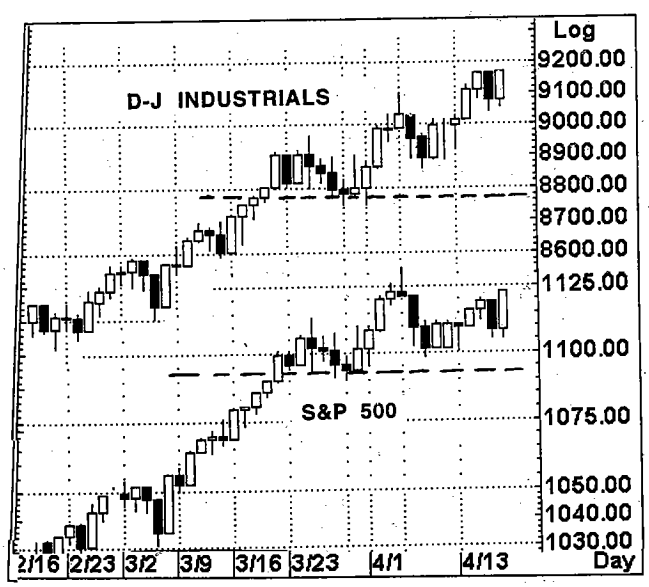
Apr. 9 DJIA 8994.86; PTI 5331; A-D Ratio +12.62
Apr. 17 DJIA 9167.50; PTI 5349; A-D Ratio +12.62
Dow Yield: 1.53%; Dow Price/Earnings: 23.6
Dow 144-day MA: 8247; Dow 34-day MA: 8829
Dow Times Book Value: 6.48; PTI 89-day MA: 5251
Percentage of Undervalued Blue-chips: 2%
Gold 34-day MA: 303

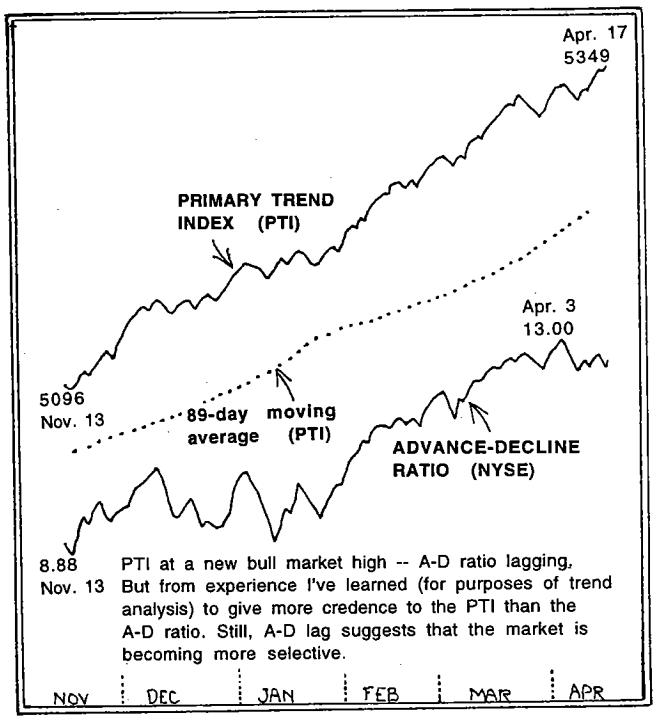
earnings growth into late-1998 or even mid-1999. Or how about a 14,000 Dow based on earnings growth extrapolated to the year 2000? It's fun, it's exciting, and it works as long as earnings continue to grow exponentially. Of course, if earnings stall or, God forbid, turn down, the system will, er uh, malfunction. But why worry about an end to earnings growth when Wall Street and the nation are in a state of euphoria? Of such are bubbles created.

WILL THERE BE WARNINGS?: I touched on this thesis in the last Letter, but here goes once again, just to make sure. A lot of investors are counting on the stock market to provide classic warning signals prior to any real trouble. For instance, classically the advance-decline ratio will diverge or turn down three or four months before the big stock averages turn down. Or the averages will diverge or a non-confirmation will appear prior to trouble. Or the market will "churn" for days (sometimes for weeks) on high volume as a major top is formed. Or the Utility Average will be down many months before the rest of the market.

These are all legitimate observations based on typical past action, but because this bull market has been so unorthodox in so many ways, I'm placing extreme **emphasis on price action itself** rather than the various time-honored, easy-to-identify warning signals. This entails simply watching the major stock averages, identifying price patterns, using moving averages and placing a lot of faith in my Primary Trend Index.

PRICE ACTION: All right, enough theory, let's turn to what the market's actually doing. And the answer is that the market's been doing very well. The D-J Industrial Averages closed at a record high of **9162.27** on April 15. On the same day the D-J Transportation Average closed at a record high of **3661.90. Simultaneous new highs** by both the Dow and the Transports constitute a powerful Dow Theory re-confirmation of the bull





market. So here's what we have -- we have the warnings on valuations, we have the warnings on earnings, we have the warnings that insiders are big sellers, we have the warnings that commercials are shorting -- and so far, the market couldn't care less.

As for my Primary Trend Index (PTI), it too recorded a record high on April 15. What does the new PTI high mean? Consider the following: there are eight "action of the market" components in the construction of the PTI. If the **majority** of these eight components are down, the PTI declines; if the majority are up, the PTI rises. It's impossible for the market to decline if the PTI is in a rising **trend.** It's equally impossible for the market to rise if the PTI is tracing out a declining trend. Refer to the PTI on the chart above. It's still rising.

Instead of the usual chart of the D-J Averages, I'm including at the bottom of page 1 a "twin" chart of the S&P and the Dow. The support levels on both of those averages are glaringly clear. On the S&P 500 it is **1090.** On the Dow it is **8780.** So let me put it this way -- as long as the S&P and the Dow hold above the above named levels, the trend for the market must be considered bullish. On the other hand, a joint breaking of these two levels would signal that there's something wrong with the picture.

A POTENTIAL SHOCKER: Some of the most original thinking and research has been, and is being done, by the brilliant Peter Bernstein [author of "Against the Gods" and editor and publisher of "Economics and Portfolio Strategy," (212)421-8385]. In recent mailings Bernstein discusses the meaning of the dividend payout (i.e., what percentage of earnings corporations pay out in dividends).

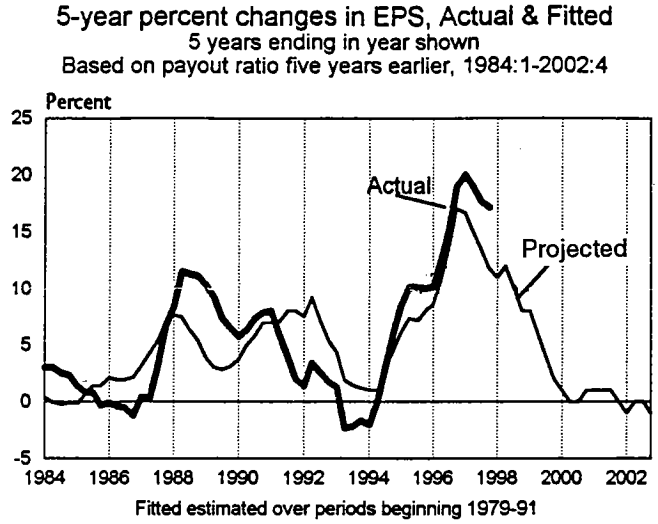
The current dividend payout for the S&P 500 is historically on the very low side. In fact, S&P states that the dividend payout will be **33%** based on their projection of this year's earnings.

The "normal" historical dividend payout for the S&P is 52%. So what's the reason for today's low payout? The rationale is that corporations would rather hold back dividends while using the money they save either to buy back their own corporate shares or to spend the extra money on other investments -- all in an effort to increase share value. In other words, according to this thesis a low dividend payout should be a plus for stockholders since the money that would ordinarily be paid out in the form of dividends will instead be used to increase the value of the stock.

But Bernstein's research comes up with a **very different conclusion:** *"The payout ratio appears to be the real determinant of future earnings . . . The lower the payout ratio today, the lower the earnings growth rate between here and five years from now, and vice versa."*

In other words, Bernstein is saying that a trend of declining dividend payout ratios is a forecaster of declining earnings five years from now. The rationale is as follows: corporate executives think long and hard before raising or lowering dividends. The act of holding back dividends in reality tends to be a vote of **caution** regarding future earnings, while the act of raising dividends constitutes a vote of **confidence** regarding future earnings.

Bernstein's chart is striking. The heavy line traces the actual percentage change in corporate earnings. The light line traces the changing ratio of the dividend payout -- Bernstein plots the light line five years into the future (as a forecast). The chart shows that the actual growth rate of earnings peaked in the first quarter of 1997, just one quarter after Bernstein's model predicted that it would. But from there on, the light line forecasts earnings growth **turning down** -- right into the year 2002.



Writes Bernstein, *"The model predicts that earnings on the S&P 500 in 2002 will be little different from what they were at the end of 1997 (the model has a standard error of estimate of three percentage points). If we take the model literally, earnings in the year 2000 will be in the mid-$30s per share, some 20% below earnings in 1997."* Adds Bernstein, *"The current consensus seems to be that earnings in 1998 will be only a little higher than last year, but we have seen nothing to suggest that analysts are anticipating a drop in earnings as large as 20% between 1997's results and two years from now. That would be a shocker."*

Russell Comment: A shocker is putting it mildly. Currently, the prevailing sentiment is extremely bullish regarding corporate earnings over the next few years (some are extrapolating rising corporate earnings as far out as the eye can see). If these rosy perceptions begin to change and the market decides that earnings growth is actually stalling out and heading down, that would require, let me put it as delicately as I can, quite a bit of downward revision on the part of the stock market. **Note:** The current analysts' consensus estimate for S&P earnings for the full year 1998 is up 9.2%. This hardly jibed with the Bernstein study.

Question: Almost all bear markets have started or developed in an atmosphere of rising interest rates. Could a bear market develop with interest rates holding steady or even declining?

Answer: A bear market could develop in the face of **declining corporate profits,** even if interest rates were to hold steady or even decline. It is well to remember that investors tend to be guided

by "rules" based on their experiences of the past, but once investors know the "rules," the market has a nasty habit of changing those rules.

CONCLUSION: As of this writing, bonds are in a trading range but with an upside bias. The stock averages, the breadth and my PTI have all been trending bullishly higher.

Question: Russell, on April 15 the D-J Industrials, the D-J Transports, the NASDAQ and your PTI all posted record highs. In view of that action, could we expect any kind of trouble ahead?

Answer: Bull markets invariably last longer than bear markets, historically, three or more times as long. On that basis alone, the odds are always against the start of a bear market. But this is a very old bull market, one that I believe started 24 years ago in late-1974.

I never forget the Dow Theory adage that states, "Each upside re-confirmation by the Averages in a bull market is accorded less validity than the previous. Finally, we will have a re-confirmation that will be the LAST re-confirmation, prior to the inception of the next bear market."

Nobody who entered the market over the last 10 years has experienced a bear market or even a serious correction. And probably 75% of those buying or holding mutual funds have entered the market during the last 10 years. Statistics show that 41% of American families now own mutual funds. It's an unprecedented situation.

On top of that, I, personally, find the **level of confidence** regarding the market today absolutely amazing. Analysts are vying with each other as to upside projections: "The Dow will be up 9% by the end of the year," "The Dow will be 10000 by late August," "The market will move sideways for a month or so, then surge over 12000." We old-timers simply shake our heads in wonderment. Personally, I can't ever remember this level of arrogance and ignorance on the part of so many supposed Wall Street "experts."

INVESTMENT POSITION: The bull remains in the box. You're bullish, bearish, hopeful, skeptical? Remember this (and it's a thesis that every Dow Theorist understands), it's a bull market until proved otherwise.

Interesting comparison -- it now costs you a record **63 dollars** to buy one dollar of S&P dividends. S&P dividends can be raised or cut so obviously they are not guaranteed. At the same time, it costs you **16.8** dollars to buy one dollar of guaranteed interest via a US Treasury bond. So the comparison is 63 dollars vs. 16.8 dollars to buy one dollar of income. The comparison is worth pondering, and a lot of wealthy people are doing just that.

There's another interesting consideration. The mutual fund public is continuing its massive buying of mutual funds, and the funds in turn are buying stocks that probably average less than 1.4% in yield. At these record low yields, the only reason to buy stocks or funds is the hope that they will move higher. If stocks and funds merely lapse into a trading range, that 1.4% is hardly an attractive return. And if the "unexpected" occurs and stocks head down, that 1.4% is slim justification for holding on -- unless, of course, you're convinced that any decline will be minor. Again, it's a situation worth pondering.

NOTES & QUOTES: Wall Street was almost hysterical regarding the giant $83 billion merger between Travelers and Citicorp. Said banking expert Ron Chernow, "This is an absolutely staggering event that redraws the financial landscape." Said Traveler's CEO, Sandy Weill, "It's a marriage made in heaven . . . We're creating the model of the financial services company of the future." One thing the merger does is put pressure on Citicorp's main competitor, Chase Manhattan, to pull off a monster merger of its own. The possible partners -- Merrill or Morgan Stanley/Dean Witter. Analysts are wondering who will be the ultimate chief honcho at the new merged company, which will be called Citigroup. San Diego's Graef Crystal (he writes the *Crystal Report*) is the world's expert on executive compensation. Says Crystal, "In a power struggle, Sandy Weill is a street fighter from Brooklyn. Reed is a gentleman. John Reed will retire. Sandy will be the survivor." One thing about the brilliant Weill, he likes money. Crystal says that Weill over time has amassed $700 million through increases in the value of stock options. Last year alone Weill exercised previous stock options worth $220 million. Says Crystal, "Two factors drive high pay packages. You have to have high long-term performance and an insatiable lust for money. If you have the performance numbers, you try to squeeze every last cent you can from the board. Sandy Weill carries his greed glands in a wheelbarrow." Citicorp's John Reed was paid a mere $14 million last year. **Russell Comment:** How are these two going to "share" their new merger pay package? It should be an interesting merger . . . Items: John Reed drinks 20 cups of coffee a day, was married for 29 years, divorced his wife, and then married the stewardess on his corporate jet. My old friend, Herman Weiss, was Sandy Weill's room-mate in college. Herman ended up being Shearson's floor manager on the NYSE when Sandy headed Shearson. Herm was smart, he retired, but Sandy's still going like a house a-fire.

Aftermath: Fearing they'd be left behind, a number of other major banks and brokerage houses announced concepts or actual plans to merge. The feverish plans by financial institutions to "couple" enveloped Wall Street almost overnight.

* *

The debate goes on regarding how to "save" Social Security. The SS program is slated to be in trouble by 2020. And you can see why so many are worried about SS. Check these statistics: 60% of US families have $1,300 or less in savings; 60% of US families have limited or no pensions. The SS program has been systematically plundered by the government; it started when LBJ, in order to finance the Vietnam War, placed SS in the US budget, meaning that all the money coming in from SS was simply spent by the government. The crowning irony was when Clinton announced in his State of the Union address that every dollar of the budget surplus should be held aside to save Social Security, this while the government continues to plunder the system. Clinton, "Mr. Status Quo," is rejecting the only logical and workable course for SS, privatization.

Clinton rejects social security privatisation

By Richard Wolffe in Washington

President Bill Clinton yesterday rejected calls to for every person drawing social security, he said.

Mr Clinton has already won broad support for his proposals to set aside future "If you do all that, could you construct some system which also made allowance for private accounts? I think you could, yes. But would I

It looks as though Paula Jones is history, but the tawdry record of the Clinton Administration will forever be a blot in the history books. Here's what the *NY Times* says in its March 5 editorial: "Mr. Starr is an odd character . . . and when it comes to public relations he is an one-man train wreck . . But nothing Mr. Starr has done excused the campaign of vilification conducted by the Clintons and their television mouthpieces. That campaign is designed to deny Mr. Starr and the taxpayers the benefits of a completed investigation into matters of legal weight about which the president and Mrs. Clinton and agencies of the Administration have consistently refused to tell the truth."

Impeach Clinton? That's the last thing the Republicans desire. Why? Because they don't want to deal with a "President Al Gore" with two years of office under his belt . . . What will be Clinton's legacy? **Russell Answer:** "Much ado about nothing." When Clinton assumed the presidency he vowed to reform health care and

shrink the gap between rich and poor. Health care is a disaster and the gap between rich and poor is now larger than ever. Euphoria over the economy saved Clinton from being destroyed by his endless scandals. Says Yale political scientist Bruce Ackerman, "This scandal is a misfortune, but the fact is that if we hadn't had the scandal we wouldn't have anything but nickel-and-dime proposals anyway." Adds James Ceaser, Univ. of Virginia presidential scholar, "Anything Clinton proposes that rests on people believing in him and his convictions would be in trouble. He doesn't have the trust of Republicans, or of Democrats either for that matter."

I watched Jay Leno a week or so ago, when Billy Crystal was the guest. Crystal was talking about his MC talk at the Academy Awards. Crystal said he was going to mention "Clinton's observance of the Nine Commandments," but he thought that in the interest of taste he had better pass on that one . . . Another wag commented on Clinton's version of the Ten Commandments; he said that Clinton referred to them as the "Ten Suggestions."

Ken Starr is close to the time when he'll be submitting his findings on Clinton and Hillary and the Democrats to the House. My bet -- Starr's finding will contain more than one impeachable offense. My further bet -- there's no chance in the world that Clinton will be impeached.

* *

There are now about 8,000 assorted mutual funds, and why not? Here's an edifying paragraph from the Sunday *NY Times:* "Starting a fund has become increasingly simple, as long as you know a good lawyer. Indeed, a would-be fund manager can hire outside companies to do everything from answering phones to pricing a portfolio. Fund supermarkets, like the big one run by Charles Schwab, also make it possible to get a fund into investors' hands without a big marketing organization. In fact, a fund company can even hire outsiders to manage their investments, leading to what Neil Bathon of the Financial Research Corp., which analyzes the mutual fund industry, calls 'the virtual fund company.'" **Russell Comment:** Are we having fun yet? Do we have enough funds yet?

* *

It looks as though a classical education is becoming a thing of the past. Sadly, a goodly portion of college graduates today can not write a decent, grammatical sentence. Consider this: high school enrollments in first year Latin in 1962 was 700,000; by 1974 the total had dropped to 25,000. From 1971 to 1991 the number of classics majors in universities dropped by 30%. Of one million bachelor's degrees awarded in 1994, only 60 were in the classics.

Speaking of education, here a few celebrity dropouts. Tea Leoni dropped out of Sarah Lawrence College. Matt Damon dropped from Harvard. Ethan Hawke dropped out of Carnegie-Mellon University. Demi Moore dropped from high school. Brad Pitt dropped from the Univ. of Missouri. Bill Gates dropped from Harvard. Jim Carrey dropped from high school. Tom Hanks dropped from Cal State Sacramento. **Russell Comment:** I tell my kids, you're not Bill Gates or Demi Moore so you guys better get your degrees.

* *

The big US brokers and funds are rolling into **Japan**, looking for a piece of that $9 trillion in Japanese savings. Merrill Lynch has jumped into Japan with both feet. Last week giant Fidelity opened its Japanese campaign with a slogan, "A new Era of Investing Begins With Fidelity." Will the Japanese go for it? With Japan's "Big Bang," the land of the rising sun has made it easier for Japanese citizens to move their funds outside the country in search of better returns.

Everybody from Clinton on down has been telling **Japan** "what it needs to do" in order to turn its economy around. The suggestions are so specific and insistent that they leave the Japanese no room to "save face." So no matter what Japanese authorities do now, they will appear to be giving in to "gaiatsu" or foreign pressure. This places the leaders of the world's second largest economy in a very difficult position. The Japanese don't like to move fast, and they hate to be embarrassed. London's *Economist* (April 11) in a lead article entitled, "Worse to Come," starts, "An invisible hand is giving Japan an almighty whack . . . First to feel the pain was the country banks. Having lent immoderate sums to just about anyone who wanted the money, they have been on the ropes ever since the collapse of stocks and land prices earlier this decade. But another wave of casualties is coming, this time in the non-financial parts of Japan's ailing economy. The implications for output and jobs are serious, more so than many Japanese understand . . . The news gets worse by the day. On April 3, Mode's, a credit-rating agency, said in effect that it was unsure whether Japan deserved its top credit rating." Writes Thomas Friedman of the *NY Times,* "Japan needs an economic revolution. For now, though, there is no ruling or opposition figure there to articulate and lead that revolution. So either America and its G-7 partners will do it by hammering Japan, or a major economic catastrophe will do it, by hammering all of us."

* *

Since February **China** has purchased an astounding $52 billion of US bonds. Most observers believe that this is part of a Chinese defense strategy. If "international" speculators backed by US capital mount an attack on China's currency, China could dump a huge chunk of its US Treasuries on the US bond market, thereby running up interest rates and creating havoc. It's the old story, "Money talks and BS walks." And the Chinese have the money.

* *

La Jolla is a suburb of San Diego. When I first moved to **La Jolla** in 1967 (I lived in San Diego from 1961 to 1967), it was a sleepy little town where "old people came to live -- along with their parents." The town was stodgy, sleepy and boring. Times have changed and so has La Jolla. The place is now a tourist Mecca and one can walk down the main street and hear 20 different languages from the mouths of tourists from around the world (although the Japanese are now missing). And wait, what's this: the famous *Robb Report* lists La Jolla as the only village in California to make its "top 10" list of the most affluent communities in the US. So forget Beverly Hills, Bel-Air, Pacific Palisades, Pebble Beach, Malibu, Newport Beach -- La Jolla has grown up and is in the chips. Or maybe La Jolla always was affluent, but when I first moved here you could buy any large, ocean-front house in the town for a 100 grand or less. Of course, 100 grand in 1967 was big money, but inflation has taken care of that. By the way, according to *Robb,* the 10 most affluent communities are Aspen, Palm Beach, FL, Greenwich, CT, Grosse Pointe Farms, MI, Kapulua, HI, Boca Raton, FL, Hilton Head, SC, the Gold Coast of Chicago, Newport, RI, and La Jolla.

* *

The talk is that the auto sales cycle is about to turn down. Of the US big three, only GM showed increased sales during the latest period, but Mercedes sales surged 22% in the first quarter. Mercedes and BMW are going full guns to capture the US luxury car market. Mercedes is even going after the limo trade with its rumored Maybach, which will sell for over $200,000. Meanwhile, VW is fighting to outbid BMW to take over Rolls Royce. The price for Rolls could be $600 million or more. Why, I don't know, since Rolls now sells only 2,000 cars a year, about 450 in the US. Of course, Rolls has a luxury name second to none.

* *

I was reading an interview with Woody Allen in the April 6 *New York* magazine, and I suddenly realized why I no longer miss my home town of New York. I grew up in Manhattan during the '30s, '40s and '50s; I left the City in 1961 and I never regretted it. In his interview Woody says, *"Once the War started the City started to degenerate. Places started to close, the city slowly started getting sucked into problems of huge welfare payments and narcotics problems, the crime problems mushroomed, television induced people to stay indoors, and the city didn't have the vitality it had when there were so many Broadway shows going and so many nightclubs that you could go to . . . I went out much more when I was young. First off, because of the kind of music that I liked. I could go see the Wilbur De Paris Band on 52 Street, I saw Louis Armstrong many times or Jack Teagaden and Miles Davis and John Coltrane. But a lot of guys have died, and what happened with music is as it happened with painting: it became more abstract. It*

became more interesting and challenging for the musicians, but less accessible to the public. So they started to lose their audience."

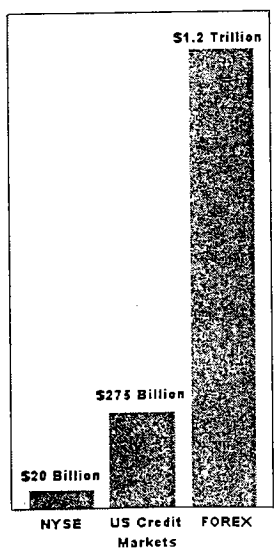
Personally, I always thought that 52nd Street was the best thing in New York. There were about 10 night clubs on 52nd Street, and back in the '40s you could walk up and down 52nd Street and hear the best jazz musicians in the world. For instance, you could drop in at "Kelly's Stables" and hear the house band, the King Cole Trio, and then Roy Eldridge would come on with Billy Holliday singing. I was in heaven, and I've never heard such exciting jazz since. And all for the price of a coke (no cover charges).

When I return to the City for an occasional visit, the place doesn't seem right to me. 52nd Street is gone, and there's nothing to replace it. Everything today is money-oriented and expensive and I feel as though the City is choking with pushy, hurrying, unsmiling people. Today every event has to be a "big deal" -- a big show by Disney, a big movie like Titanic, a big restaurant that makes a big deal out of giving you a table in Cirque 2,000. Did you hear, there's a really big show at the Whitney, there's a whopper at MOMA and there's even a bigger show at the Met. Hey, how can I get a table at Jean-George?

I just don't enjoy New York much any more. Maybe it's the current preoccupation with money, maybe it's the hassle, maybe it's the mania for what's "in," maybe there are just too damn many people living in too limited a space. But most of all, I think when 52nd Street closed down they somehow (at least to me) took the guts out of Manhattan. So I know what Woody Allen means when he says of New York, "Once the War started, it started to degenerate." He's talking about the fascinating pre-War New York, the exciting amateur New York that existed during the '30s and '40s. Gone, nearly forgotten, never to return. That's the New York I miss.

* *

This chart, courtesy of *Market Technicians Association,* shows what's going on in daily volume in the various markets these days. Here we see the NYSE, the credit markets (bonds, bills, notes, etc.) and the new guy on the street, the FOREX or foreign exchange market. Actually the FOREX has expanded since this chart was made, and is now doing about $1.4 trillion a day (not a week, a day). What is so fascinating about all this is that the markets are now **taking over power from the governments**. Of course, the markets are also a hell of a lot smarter than governments. Governments are run by one man, a few men or a committee. Markets are runs by hundreds of thousands or millions of people. Governments rule by edict; markets rule by money.



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The US and China have found a new theme that both of them like. Hardly a day goes buy without some Administration person telling us about "good China," which is holding the line on the yuan and actually easing up on personal freedom. At the same time we're told about "bad Japan," which is not stimulating its economy enough and is just not following the US's orders and recommendations.

* *

In listing US presidents who were slave-holders in a recent Letter, I included poor old Ben Franklin. Of course Franklin was never president -- hey I knew that. I just included Franklin in the list to see if my subscribers were on the ball and still able to pick out one of my amazingly rare mistakes. (Actually, I deny the Franklin thing was my fault, let's just say that "mistakes were made," probably by one of my staff -- or could it have been my printer?)

* *

In the current *Forbes* magazine presidential candidate and publisher, Steve Forbes, complains that **real** (inflation adjusted) interest rates in the US are too high. He notes that without inflation the "short-term cost of money still hovers around 5%. Traditionally the real price (in view of today's non-inflation) would be under 2%." **Russell Comment:** While keeping short rates steady at around 5% even as inflation appears non-existent (at least according to the government), the Fed is indirectly tightening rates. Thus, the Fed is also allowing the money supply to surge while rates continue on the tight side. Also, US long rates are among the highest of any developed nation.

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Were the "good old days" of the '40s and '50s better than the '90s? In some ways, yes, in other ways, no. In medicine and health, there's no comparison -- people are much better off today. For instance, I had a mastoid infection in 1932 when I was eight. I was operated on and almost died in the process. Today most doctors have never seen a mastoid operation. Anti-biotics have rendered such operations and infections obsolete. But medicine today costs more as does a college education. But housing in the '50s cost 6.5 man hours of work per square foot, now it costs 5.6 hours. Goods are also cheaper in terms of man hours. A pound of ground beef cost 23 minutes of labor in the '50s, today a pound costs 6 minutes. A gallon of gas in the '50s cost 11.2 minutes, today a gallon costs 5.7 minutes. And 41 hours of air travel in the '50s cost 41 man hours of work, today it costs 10.8 man hours. A dishwasher cost 140 man hours in the '50s, today it costs 23 hours. How about the following: today 98% of American households have a phone, 97% have a TV, 80% have a car, 65% have a stereo, and 43% have a computer.

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Solutions? During the French Revolution the entire tax bureau was herded off to the guillotine and beheaded. Question: Would that work today with the IRS? Answer: Nah, it would probably be considered too drastic . . . Since 1961 loyal Americans have sent the Treasury gifts totaling $56.8 million, all in an effort to reduce the national debt, which now stands at $5.6 trillion. Unfortunately, the $56.8 million that these concerned Americans sent in only takes care of the **interest** on the national debt for about an **hour and a half** . . . On the Y2K Millennium bug situation, the *Sunday Times* of London quotes a senior executive of Barclays Bank as offering the following advice: "The average man or woman does not appreciate what is going to happen. I'm going to plan for the absolute worst. I'm talking about candles, tinned food and bottled water from mid-1999 on. People think I'm mad, but a company director I met last week is intending to set up a commune and buy a shotgun because the potential for looting is high." **Russell Comment:** If the world had stayed with Macs instead of Microsoft software, Y2K never would have happened . . . John McGinley of *Technical Trends* is worried that the Dow will be stuck at 10000 for 16 years (just as it was stuck at 1000 for 16 years) all because computers won't log in a five-figure Dow (don't worry, he's only kidding).

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A survey of 409 senior executives of US firms whose sales exceed one billion dollars produced some interesting results. The survey by the giant accounting firm of Deloitte and Touche said that "by 2005 90% of executives expect to rely on the **Internet** as their primary source of business news, pushing aside traditional news media." Also included in the survey, the executives said that they depend 35% on TV, 32% on weekly news magazines, 21% on weekly newspapers, and 12% on radio. **Russell Comment:** I now depend on 12 newspapers and maybe 40 magazines, plus CNBC and Bloomberg TV, but, most of all, I depend on a computer screen that provides instant quotes, instant charts, and instant news. This prediction hasn't halted the proliferation of financial magazines. In 1990 there were three financial magazines; today there are 19 magazines all purporting to tell you how to handle your money. Most of the advice has to do with which mutual funds to buy. The two I like best are *Bloomberg* and *Worth.*

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According to the Justice Dept., 40% of all violent crimes are alcohol related. But if you get drunk or are carrying a closed bottle of whiskey, you're not arrested. Today, there are tens of thousands

of people in prison, some with very long sentences, for using drugs. Fact: cigarettes kill more people than drugs and alcohol ever will. So why the continuing war on drugs? It's illogical, and it reminds me of the attitude of just a few years ago towards Social Security. Remember when they called SS the "third rail," because as a politician if you touched it you were dead? That's where the war on drugs is today. Even question it and you're dead.

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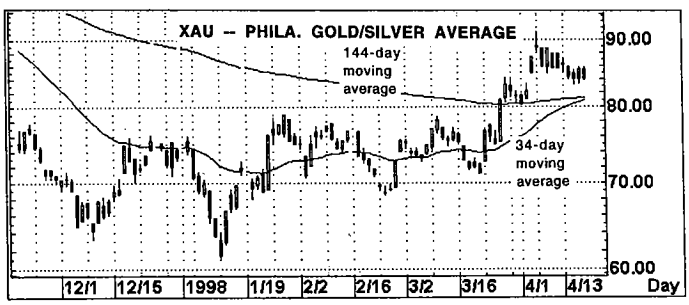
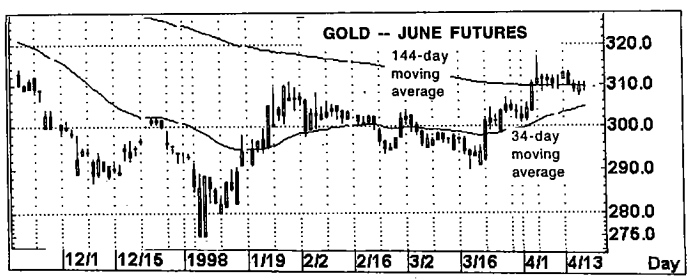
Seinfeld, probably the most successful sitcom in TV history, is wrapping it up in an one-hour final show scheduled for May. Ads for the show cost a huge $2 million for half a minute. The show started slowly, then gathered a following. Even the network doubted that it would go. Said Brandon Tartikoff (the late president of NBC), "Who'd want to watch four Jews walking around New York?" Wrong, tens of millions of Americans wanted to watch them. And the prediction is that 75 million people will watch the final (sob) episode of Seinfeld. As for Jerry Seinfeld, he'll come out OK. The talk is that he'll pick up at least $200 million from re-runs.

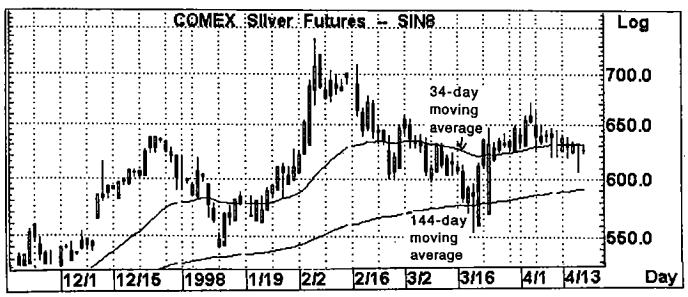
PRECIOUS METALS: The government just can't leave gold-holders alone. You may not know it but only newly minted gold and silver coins issued by the federal government and commemorative coins issued under state law are subject to the 20% long-term capital gains tax when they are sold. If you sell, for instance, Maple Leafs or Krugerrands you are subject to the old maximum 28% tax rate.

The Phila. Gold/Silver Index (XAU) is looking a lot better. Note that the 34-day MA is just about to push up ABOVE the 144-day MA, and this constitutes a major plus. The upside target for XAU is the April 6 closing high of 88.89. Bettering that level would add luster to the whole gold and silver complex.



Gold (June futures) itself looks better than it has in quite a while. Gold, so far, is holding above its 34-day MA, which is rising. The upside target for gold June futures is the April 1 closing price of 312.9. No hurry, but it would be nice to see that happen.

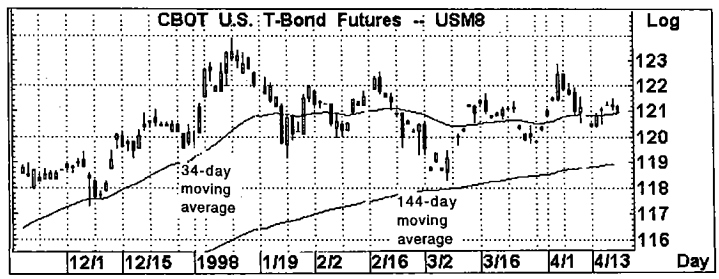




As for **silver**, the metal is stronger than gold. I say that because the 34-day MA of silver (unlike gold) is above the 144-day MA. The 34-day MA for the July silver futures stands at 6.314, although silver is now below it. To be clearly bullish, the July silver futures would have to be above 6.32. My guess -- neither silver nor gold appear ready to rally above their previous peaks, but the overall situation in the precious metals looks better than it has in quite some time.

BONDS: According to rumors, a goodly segment of the Fed board now believes that rates should be raised. Why? The US money supply is booming, and the stock market frenzy is spilling over into housing and real estate. Only two items are holding interest rates back (1) the deflationary effects coming out of Asia, and (2) the statistics that suggest that overall inflation is running at 1.5% or less, a figure which few consumers believe.

At any rate, the bond chart (June futures) shows bonds milling about in a trading range. However, the 34-day moving average is still holding well above the 144-day MA, a sign of longer-term strength. The June bond futures, however, are sitting right on their 34-day MA. So far, a stand-off.



ECONOMIST: Probably the most prestigious economic magazine in the world is London's *Economist.* Even Bill Gates says he reads the *Economist* cover to cover. The latest issue (April 18) was a bit of a shocker. The cover story is entitled, "America's Bubble Economy." I have included the first two paragraphs of the opening article below. Frankly, I was surprised, because I can't remember the *Economist* (which I always read) taking this strong a stand on the US situation. Read these two paragraphs and mull them over.

AN ECONOMIST, it is said, is an expert who will know tomorrow why the things he predicted yesterday did not happen today. So what will be tomorrow's explanation of why share prices continue to soar today despite frequent warnings from many commentators (including *The Economist*) that Wall Street is overvalued? The most popular explanation within America is that it has entered a new economic era of faster, inflation-free growth, and hence stronger profits, thanks to new technology and globalisation. We beg to differ: America is experiencing a serious asset-price bubble.

This week's spring meetings of the IMF and the World Bank were dominated by talks about the slump in Japan and how to prevent another financial crisis like that in East Asia. These subjects certainly still matter. But it is asset-price inflation, especially in the United States, that now poses a bigger and more imminent threat to the global economy. America's stockmarket has gained another 15% this year, taking its total rise over the past two years to a massive 65%. This is not the only symptom of a bubble: America's commercial property market is starting to get frothy, and mergers are running at record levels (see page 67). Shares surged on the news of the huge mergers between Citicorp and Travelers, BankAmerica and NationsBank, and First Chicago and Banc One. Ominously, merger mania is usually associated with the final stages of a bull market.

NEXT MAILING: May 6, 1998